

Evolve Canadian Banks and Lifecos Enhanced Yield Index

BANK seeks to replicate, to the extent reasonably possible before fees and expenses, up to 1.25x the performance of the Solactive Canadian Core Financials Equal Weight Index, while writing covered call options on up to 33% of the portfolio securities to mitigate downside risk. The level of covered call option writing may vary based on market volatility and other factors.

TSX

BANK

ETF TICKERS: BANK (UNHEDGED)

2022 was a challenging year for Canadian equities, to say the least. In fact, during the year, the S&P/TSX 60 Index returned -6.24% on the back of recessionary concerns following multiple consecutive quarters of negative GDP growth. Furthermore, with Canadian inflation rates at 6.3% on a year-over-year basis¹, the Bank of Canada has raised rates by 4.25% since the beginning of 2022 in an effort to combat inflation. The year began with rates at 0.25% and closed the year out at 4.25%, pushing borrowing costs to their highest level since 2008.³ The Bank of Canada has signalled that there will be more rate hikes to come, predicting that inflation will decline to about 3% by the end of next year, and will hit its 2% target by 2024.⁴ Financial services and insurance providers typically performs well in a rising interest rate environment such as the one experienced in 2022. More specifically, financial institution revenues are usually positively correlated with higher interest rates because the net margins on the bank's loan book increases. In the case of insurance providers, the relationship between interest rates and insurance company revenues is linear, meaning the higher the rate, the greater the revenue growth.² This sentiment was echoed by the Royal Bank of Canada (RBC) Chief Executive Officer, Dave McKay, when he explained that the lower rates throughout the pandemic had been a drag on the banks' revenues saying, "We are well-positioned to benefit from rising interest rates, given our leading Canadian deposit franchise and the asset-sensitive nature of U.S. wealth management style sheets," McKay told investors during their December 2021 conference call. He added, "To highlight the potential benefit over time, the impact of lower interest rates reduced our revenue by approximately \$1 billion in each of the last two years."³

This sentiment was reflected in the earnings results of Canadian Banks and Lifecos released throughout the year. In its fiscal third quarter 2022 report, Scotiabank, a holding in this Fund, announced net income of \$2.59 billion compared to \$2.54 billion in the same period last year. The bank also announced diluted earnings per share (EPS) of \$2.09, compared to \$1.99 in the same period in 2021.⁴ Toronto-Dominion Bank Group, another holding in this Fund, announced third quarter diluted EPS of \$1.75, compared with \$1.92 in the third quarter of 2021. However, its Canadian Retail business reported a revenue increase of 7% compared with the third quarter of 2021 and attributed the increase to rising interest rates and growth in consumer activity.⁵ While National Bank of Canada, a holding in this Fund, reported third quarter diluted EPS of \$2.35, down 2% from the in the year previous driven by higher provisions for credit losses recorded to reflect a less favourable macroeconomic outlook.⁶ Manulife Financial Corporation, also a holding in this Fund, reported third quarter net income of \$1.3 billion, down \$0.2 billion from the third quarter of 2021; and diluted EPS of \$0.68, down from \$0.80 in the same period in the year previous.

The Lifeco partially attributed the decrease in net income to the impact of markets during the quarter, highlighting that unfavourable equity market performance and losses from the sale of available-for-sale bonds were partially offset by gains due to rising interest rates in the U.S., a flattening of the yield curve in Canada, and widening corporate spreads in the U.S.⁷ Sun Life Financial Inc., another holding in this Fund, also reported underwhelming results, announcing third quarter net income of \$466 million, down 54% year-over-year; and diluted EPS of \$0.80 down from \$1.74 in the same quarter in the year previous. Unsurprisingly, Sun Life cited similar market challenges as Manulife when attributing the draw down in earnings.⁸

Other noteworthy headlines during the year included that of RBC, a holding in this fund, which announced that it will acquire HSBC Canada for \$13.5 billion on November 29th, 2022. The acquisition will allow RBC to grow its operations through the addition of 130 branches, 4,200 employees, and 780,000 customers in Canada.⁹ Finally, in December, the Bank of Montreal, a holding in this fund, announced the issuance of common shares pursuant to a public offering totaling approximately \$3.15 billion.¹⁰

Performance Attribution

For the twelve month period ending December 31, 2022, Manulife Financial Corp. made the biggest contribution to the Fund, followed by Sun Life Financial Inc. By weight, the Fund's largest holdings were Sun Life Financial Inc., Manulife Financial Corp, and Royal Bank of Canada.

Sources:

1. <https://www.bloomberg.com/news/articles/2023-01-17/inflation-slows-to-6-3-in-canada-opening-door-to-rate-pause?leadSource=verify%20wall>
2. <https://www.investopedia.com/articles/investing/052814/these-sectors-benefit-rising-interest-rates.asp>
3. <https://financialpost.com/fp-finance/banking/canadas-big-banks-poised-to-benefit-from-rising-interest-rates-after-emerging-unscathed-from-pandemic>
4. https://www.scotiabank.com/content/dam/scotiabank/corporate/quarterly-reports/2022/q3/Q322_Quarterly_Press_Release-EN.pdf
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